Supreme Court, U.S.
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No.

In the Supreme Court of the United States

October Term, 1987

QUALITY MARKETS, INC.,
Appellant

vs.

COMMONWEALTH OF PENNSYLVANIA,
Appellee

On Appeal From the Supreme Court of Pennsylvania

JURISDICTIONAL STATEMENT

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v.

COMMONWEALTH OF PENNSYLVANIA,

Appellee

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JURISDICTIONAL STATEMENT

Pursuant to Rules 12.3 and 15 of the Rules of the Supreme Court of the United States, Appellant, Quality Markets, Inc., files this statement of the basis upon which it is contended that the Supreme Court of the United States has jurisdiction to review the order and judgment entered by the Supreme Court of Pennsylvania in this case and should exercise such jurisdiction herein.

I. QUESTION PRESENTED

Whether the Commonwealth of Pennsylvania, by affording both domestic and foreign corporations the option of computing their taxes based on capital stock value through either a three-factor (tangible property, payroll and sales) or a single-factor (all property) apportionment method but requiring that foreign corporations electing the single-factor apportionment method include in the numerator thereof *all* intangible property, wherever located, thereby taxing assets beyond the taxing power of the Commonwealth and exposing foreign corporations to the risk of multiple taxation, violates the Due Process, Equal Protection or Commerce Clauses of the Constitution of the United States?

II. LIST OF ALL PARTIES

The parties to the proceeding below are those contained in the caption of this case.

The following entities are parent companies, subsidiaries (except wholly owned subsidiaries) and affiliates of Appellant—Quality Markets, Inc.:

Parent:

The Penn Traffic Company
319 Washington Street
Johnstown, PA 15901

Subsidiaries:

None

Affiliates (stock wholly owned by the Penn Traffic Company):

U-Save Foods, Inc.	PennWay Express, Inc.
Sunrise Properties, Inc.	RM Markets of Indiana, Inc.
Dairy Dell, Inc.	Clean Floor, Inc.

III. TABLE OF CONTENTS

		Page
I.	Question Presented	ii
II.	List of All Parties	iii
III.	Table of Contents	iv
IV.	Table of Authorities	v
V.	Opinions Below	1
VI.	Basis for Jurisdiction	2
VII.	Constitutional and Statutory Provisions	4
VIII.	Statement of the Case	6
IX.	The Question in this Case is Substantial	14
X.	Conclusion	15
XI.	Appendix:	
	Pennsylvania Statutes:	
	Act of March 4, 1971, P.L. 6, No. 2, Art. IV, §401, as amended, Pa. Stat. Ann. (Purdon Supp. 1982), Title 72, §§7401(3)2.(a)(10)-(17)	6a
	Act of March 4, 1971, P.L. 6, No. 2, Art. VI, §601 and §602, Pa. Stat. Ann. (Purdon Supp. 1982) Title 72, §7601 and §7602	2a
	Order, dated June 1, 1984, of the Board of Finance and Revenue	9a
	Opinion of the Commonwealth Court of Pennsylvania	10a
	Order, dated August 8, 1986	20a

Per Curiam Order, dated September 11, 1986 of the Commonwealth Court of Pennsylvania 21a
Per Curiam Order, filed June 1, 1987 of the Supreme Court of Pennsylvania 22a
Notice of Appeal to the Supreme Court of the United States 23a

IV. TABLE OF AUTHORITIES

CASES:

Armco. v. Hardesty, 467 U.S. 638 (1984) 11
Central Railroad Company v. Pennsylvania, 370 U.S. 607 (1962), rehearing denied 371 U.S. 856 (1962) 3
Commonwealth v. Carheart Corp., 450 Pa. 192, 299 A.2d 628 (1973) 8
Commonwealth v. Universal Trades, 392 Pa. 323, 141 A.2d 204 (1958) 10
Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) 10
Cream of Wheat Co. v. Grand Forks County, 253 U.S. 325 (1920) 10
Dale National Bank v. Commonwealth, 502 Pa. 170, 465 A.2d 965 (1983) 8
Gilbert Associates, Inc. v. Commonwealth, 498 Pa. 514, 447 A.2d 944 (1982) 6
Hans Rees' Sons v. North Carolina, 283 U.S. 123 (1931) 11

Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978) 10
Norfolk & W.R. Co. v. Tax Commission, 390 U.S. 317 (1968) 6, 10
Tyler Pipe Industries v. Washington Dept. of Revenue, U.S. (55 Law Week 4978), No. 85-1963, decided June 23, 1987 . 11
Wheeling Steel Corp. v. Fox, 298 U.S. 193 (1935) 6

CONSTITUTIONAL PROVISIONS:

Art. I, §8, cl. 3 4
Amendment XIV, §1 4

STATUTES:

Act of March 4, 1971, P.L. 6, No. 2, Art. IV, §401(3)2.(a) (10) through (17), as amended, Pa. Stat. Ann., Title 72, §7401(3)2.(a) (10) through (17), (Purdon Supp. 1982) 4
Act of March 4, 1971, P.L. 6, No. 2, Art. VI, §601 and §602, as amended, Pa. Stat. Ann., Title 72, §7601 and §7602, (Purdon Supp. 1982) 4
Act of June 22, 1931, P.L. 685, No. 250, §1, as amended, Pa. Stat. Ann., Title 72, §1896, (Purdon 1949) 4

RULE:

Pa. R.A.P. 1571 ..... 2, 8

V. OPINIONS BELOW

The unreported Decision and Order of the Pennsylvania Board of Finance and Revenue denying the Appellant's Petition for Refund of a portion of its Pennsylvania Franchise Tax for the fiscal year ended January 30, 1982 is reproduced at Appendix p. 9a.

The Opinion and Order of the Commonwealth Court of Pennsylvania is reported at Pa. Commonwealth Ct. , 514 A.2d 228 (1986), and is reproduced (in slip opinion form) at Appendix p. 10a.

The *per curiam* Order of the Supreme Court of Pennsylvania affirming the decision of the Pennsylvania Commonwealth Court is reported at Pa. , 526 A.2d 357 (1987), and is reproduced at Appendix p. 22a.

VI. BASIS FOR JURISDICTION

This appeal arises from a denial of a Petition for Refund of Pennsylvania Franchise Tax filed by the Appellant with the Pennsylvania Board of Finance and Revenue, a quasi-judicial administrative review board. The Appellant's Petition for Refund claimed that the Pennsylvania taxing statute and the practices of the Department of Revenue, as applied to the Appellant, violated the Commerce Clause, the Due Process Clause and the Equal Protection Clause of the Constitution of the United States.

The Appellant appealed from the denial of the Petition for Refund to the Commonwealth Court of Pennsylvania. An appeal to the Commonwealth Court from the Board of Finance and Revenue is *de novo*, Pa. R.A.P. 1571. The parties entered into a complete Stipulation of Facts and the matter was argued before the Commonwealth Court on February 5, 1986. The Commonwealth Court filed an Opinion and Order on August 8, 1986, affirming the Order of the Board of Finance and Revenue. On September 5, 1986, Appellant timely filed Exceptions to the Commonwealth Court's Opinion and Order. On September 11, 1986, the Commonwealth Court filed an Order dismissing Appellant's Exceptions and entering the Court's prior Order of August 8, 1986 as a final Order.

On September 30, 1986, Appellant timely filed a Notice of Appeal to the Pennsylvania Supreme Court in the Commonwealth Court.

Basis for Jurisdiction

The Supreme Court of Pennsylvania entered a *per curiam* Order and judgment on June 1, 1987 affirming the Order of the Commonwealth Court.

A Notice of Appeal to the Supreme Court of the United States was filed in the Supreme Court of Pennsylvania on August 10, 1987.

The jurisdiction of this Court is invoked under the provisions of Title 28, United States Code, Section 1257(2).

Cases that sustain the jurisdiction of this Court include: *Central Railroad Company v. Pennsylvania*, 370 U.S. 607 (1962), rehearing denied 371 U.S. 856 (1962).

VII. CONSTITUTIONAL AND STATUTORY PROVISIONS

United States Constitution

Art. I, §8, cl. 3

Section 8. The Congress shall have Power . . . to regulate Commerce . . . among the several States. . . .

Amendment XIV, §1

Section 1. . . . nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Pennsylvania Statutes

Act of March 4, 1971, P.L. 6, No. 2, Art. IV, §401(3)2.(a) subparagraphs (10) through (17), as amended, Pa. Stat. Ann., Title 72, §§7401(3) 2.(a) (10) through (17), (Purdon Supp. 1982)

Reproduced at Appendix p. 6a.

Act of March 4, 1971, P.L. 6, No. 2, Art. VI, §601 and §602, as amended, Pa. Stat. Ann., Title 72, §7601 and §7602, (Purdon Supp. 1982),.

Reproduced at Appendix p. 2a.

Act of June 22, 1931, P.L. 685, No. 250, §1, as amended, Pa. Stat. Ann., Title 72, §1896, (Purdon 1949).

"Whenever any corporation, joint-stock association, limited partnership, or company, subject to tax upon its

capital stock imposed by and under the laws of this Commonwealth, owns assets which are exempted or relieved from the capital stock tax under the laws of this Commonwealth, the proportion of the capital stock exempted or relieved from the capital stock tax, by reason of the ownership of such assets, shall be the proportion which the value of such assets bears to the value of the total assets owned by such corporation, joint-stock association, limited partnership, or company."

VIII. STATEMENT OF THE CASE

This case involves the taxation of intangible assets by the Commonwealth of Pennsylvania in a manner that is contrary to the decisions of this Court. *Wheeling Steel Corp. v. Fox,* 298 U.S. 193 (1935), *Norfolk & W.R. Co. v. Tax Comm'n,* 390 U.S. 317 (1968).

The case arises from the requirement of the Commonwealth of Pennsylvania that a foreign corporation electing to use a single-factor (all property) apportionment method[1] to compute its Pennsylvania Foreign Franchise Tax must be taxed as if it were a *domestic* corporation and include in the numerator of that apportionment fraction the full value of all of the intangible assets[2] of the corporation, *regardless of the situs of those assets or the relationship of those assets to the taxpayer's Pennsylvania business activities.*

The Commonwealth of Pennsylvania imposes a tax upon the capital stock values of Pennsylvania (domestic) corporations and non-Pennsylvania (foreign) corporations (Appendix pp. 2a, 4a, §601, §602(a) & (b)). The taxpayer may choose between two statutory apportionment methods to determine the portion of its capital stock value that reflects its business activities within Pennsylvania. *Gilbert Associates, Inc. v. Commonwealth,* 498 Pa. 514,

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[1] See footnote No. 4.

[2] Except for the value of the stock of subsidiary corporations more than 50% owned, stock of corporations subject to the Capital Stock Tax, obligations of the United States and Pennsylvania, and National Bank Stock, all of which are exempt under decisions of the Pennsylvania courts, under Pennsylvania statutes or under federal statutes.

447 A.2d 944 (1982). The apportionment methods are the "three-factor" (tangible property, payroll and sales) method[3] and the "single-factor" (all property) method.[4] The apportionment factor is multiplied by the capital stock value to determine the taxable value. The tax rate is then applied to this taxable value to compute the tax.

The Appellant filed a Petition for Refund with the Pennsylvania Board of Finance and Revenue claiming a partial refund of its Foreign Franchise Tax for the fiscal year ended January 30, 1982. In the Petition for Refund, the Appellant exercised its right to use the single-factor apportionment method, but claimed that the administrative requirement of the Pennsylvania Department of Reve-

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[3] This method is commonly found in state corporate income tax statutes and is provided in the Act of March 4, 1971, P.L. 6, No. 2, Art IV, §401(3)2(a) (10)-(17), as amended Pa. Stat. Ann. Title 72 §7401(3)(2)(a)(10)-(17) (Purdon Supp. 1982), made applicable to the Capital Stock and Foreign Franchise Taxes by §602(b) Pa. Stat. Ann. Title 72 §7602(b) (Purdon Supp. 1982). See Appendix p. 6a. The formula consists of the average of the ratios of the tangible property, payroll and sales of the taxpayer attributable to the taxpayer's in-state activities to the total tangible property, payroll and sales of the taxpayer, as follows:

$$\left(\frac{\text{Pennsylvania Tangible Property}}{\text{Total Tangible Property}} + \frac{\text{Pennsylvania Payroll}}{\text{Total Payroll}} + \frac{\text{Pennsylvania Sales}}{\text{Total Salese}} \right) \div 3 = \text{Apportionment Factor}$$

[4] The single-factor method is derived from the Act of June 22, 1931, P.L. 685, No. 250, §1, as amended, Pa. Stat. Ann., Title 72, §1896 (Purdon 1949). The Act is set forth verbatim at p. 4 hereof. The single-factor apportionment method consists of a fraction having as its numerator the book value of all of the taxpayer's assets less the book value of any assets exempt from taxation under law and having as its denominator the book value of all of the assets of the taxpayer. This "single-factor" apportionment method is illustrated as follows:

$$\frac{\text{Total Assets—Exempt Assets}}{\text{Total Assets}} = \text{Apportionment Factor}$$

nue that the full value of all of its intangible assets be included in the numerator of the single-factor apportionment fraction was violative of the Due Process, Equal Protection and Commerce Clauses of the United States Constitution. These issues were thereafter raised and preserved in the *de novo* appeal to the Pennsylvania Commonwealth Court and in the subsequent appeal to the Pennsylvania Supreme Court. See: Pa. R.A.P. 1571.

The Appellant is a New York corporation engaged in the operation of twenty-one (21) retail grocery stores. Appellant's corporate headquarters, distribution center, and commercial domicile are located in Jamestown, New York. All administrative, management and corporate functions relating to Appellant's business are conducted exclusively in New York. Appellant's sole business activity in Pennsylvania is the operation of eight (8) retail grocery stores[5]. (S/F ¶ ¶ 1, 2, 13, 14, 17, 19).

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[5] The Appellant and the Commonwealth entered into a complete Stipulation of Facts (S/F) which is binding upon the parties. *Commonwealth v. Carheart Corp.* 450 Pa. 192, 299 A.2d 628 (1973), *Dale National Bank v. Commonwealth*, 502 Pa. 170, 465 A.2d 965 (1983). The references are to the paragraphs of the Stipulation of Facts containing the facts set forth herein.

The following is a list of the Appellant's intangible assets during the tax year in question, classified under generally accepted accounting principles:

Cash	$ 504,300
Accounts Receivable	181,227
Stocks	205,244
Stocks in Topco Associates	5,050
Investment Certificates-Topco Associates	22,949
Capital Leases	2,350,756
Deferred Income Tax Benefits	148,697
Inter-company Receivable	2,407,000
Prepaid Real Estate Taxes	49,184
Prepaid Miscellaneous Expenses	4,500
	$5,878,907

The stipulated facts establish that, with regard to each intangible asset, either (1) the asset has no taxable situs in Pennsylvania or (2) is unrelated to Appellant's activities in Pennsylvania or (3) that only a portion of the intangible asset (e.g., cash, capital leases, prepaid real estate taxes) is rationally related to Appellant's Pennsylvania business activities. (S/F ¶ ¶ 21-41)

The Commonwealth has not disputed the Appellant's claim that all or a portion of the intangible assets in question had no situs in Pennsylvania and were unrelated to Appellant's Pennsylvania business activities. The Commonwealth has claimed only that the Appellant must include the full value of *all* its intangible assets in the numerator of the single-factor apportionment fraction *because domestic corporations are required to include all of their intangible assets in the numerator of the single-factor apportionment fraction*. Domestic corporations must include all of their intangible assets in the numerator of the single-factor

apportionment fraction because such intangibles are deemed to have a taxable situs in Pennsylvania, the state of incorporation or corporate domicile. See: *Cream of Wheat Co. v. Grand Forks County*, 253 U.S. 325 (1920); *Commonwealth v. Universal Trades*, 392 Pa. 323, 141 A.2d 204 (1958). (S/F ¶ 12(a)(2)).

The Appellant contends that the inclusion by the Pennsylvania Department of Revenue of the full value of *all* of the intangible assets of the Appellant in the numerator of the single-factor apportionment fraction is contrary to the most fundamental constitutional principle of state taxation: a state may not tax assets or values of a foreign corporation which do not have a taxable situs within the geographical boundaries of the taxing state and which have no rational relationship to the activities of the corporation conducted within the state. *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

The Pennsylvania Department of Revenue makes no attempt to determine if the intangible assets of a foreign corporation have a taxable situs within the Commonwealth or relate, *in any manner*, to that corporation's business activities conducted within Pennsylvania. (S/F ¶ 11(b)). The requirement of the Department is, on its face, intrinsically arbitrary in that it results in the taxation of a portion of the capital stock value of the Appellant (and other foreign corporations using the single-factor apportionment method) attributable to intangible assets having no taxable situs in Pennsylvania and not rationally related to the corporation's business activities in Pennsylvania and is, therefore, violative of the Due Process Clause of the United States Constitution. *Norfolk & W.R. Co. v. Tax Com-*

mission, 390 U.S. 317 (1968); *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931).

Furthermore, the Commonwealth's taxing scheme lacks the "internal consistency" required in the taxation of interstate taxpayers, and thereby subjects the Appellant (and other similarly situated foreign corporations) to the risk of multiple taxation and a higher overall tax burden than that imposed upon domestic corporations. As a result, the Commonwealth's taxing scheme is violative of the Commerce Clause of the United States Constitution. *Armco v. Hardesty*, 467 U.S. 638 (1984), *Tyler Pipe Industries v. Washington Dept. of Revenue*, U.S. , (55 Law Week 4978), No. 85-1963, decided June 23, 1987.

The Pennsylvania Commonwealth Court in its opinion below, correctly held that the Commonwealth does not have the power to levy a franchise tax upon intangible assets held by a foreign corporation doing business in the Commonwealth, which assets have no connection with Pennsylvania. That Court further held that if foreign corporations were *required* to use only the single-factor apportionment method, which includes intangible assets, an unconstitutional result would occur. See Slip Opinion of Commonwealth Court at p. 5, Appendix p. 15a.

However, the Commonwealth Court then went on to hold that because the Appellant was afforded an *option* to choose between the unconstitutional single-factor apportionment method and the constitutional three-factor method, there was no unconstitutional result under either the Due Process or Commerce Clauses. See Slip Opinion of Commonwealth Court at pp. 5-6, Appendix pp. 15a-16a.

In essence, the Commonwealth Court held that because the Appellant could choose a constitutionally accept-

able method of apportionment (three-factor) there was no discrimination against or unequal treatment of Appellant, even though the alternative apportionment method (single-factor) was to be computed in an admittedly unconstitutional manner, because the Appellant would never choose the unconstitutional method unless it would result in a lesser tax.

This analysis by the Commonwealth Court failed to recognize and address the essential constitutional issues in this case. Because an electing foreign corporation is required by the Commonwealth's taxing scheme to include the value of all of its intangible assets in the numerator of the single-factor apportionment fraction, the tax resulting from that apportionment method is necessarily greater than the tax which results from computing the single-factor apportionment fraction of foreign corporations in a constitutionally permissible manner. Furthermore, the tax computed using the single-factor method, computed as required by the Commonwealth, is virtually always greater than the tax computed using the three-factor method.[6]

This scheme of taxation discriminates against Appellant and other foreign corporations and in favor of domestic corporations in violation of the Equal Protection Clause and Commerce Clause of the United States Constitution by taxing assets outside the taxing jurisdiction of the Commonwealth thereby effectively precluding the ability of foreign corporations to choose the single-factor apportion-

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[6] For example, Appellant's tax was settled at $29,127 using the three-factor method. (S/F ¶ 5) Appellant's tax using the single-factor method, computed as required by the Commonwealth would be $38,656.50. (S/F ¶ 47). Appellant's tax using the single-factor method computed to exclude intangible assets which are not related to Appellant's activities in Pennsylvania would be $16,379.52. (S/F ¶ 45).

ment method. The option required to be afforded to foreign corporations under the Pennsylvania scheme of taxation is, in reality, not an option. Only *domestic* corporations have the unfettered ability to choose either method of taxation.

IX. THE QUESTION IN THIS CASE IS SUBSTANTIAL

The constitutional issues presented in this case directly concern thousands of non-Pennsylvania corporations doing business in Pennsylvania and subject to the Pennsylvania Foreign Franchise Tax.

The method of taxation imposed by Pennsylvania on foreign corporations, if permitted to stand, would provide a means for states to tax intangible assets having no taxable situs in such states and thereby unconstitutionally discriminate against foreign corporations in favor of domestic corporations.

X. CONCLUSION

For the foregoing reasons, it is respectfully urged that the Supreme Court of the United States exercise its jurisdiction to hear this Appeal.

Respectfully submitted,
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APPENDIX

Appendix

PENNSYLVANIA STATUTES

Act of March 4, 1971, P.L. 6, No. 2, Art. VI, §601 and §602, Pa. Stat. Ann. (Purdon Supp. 1982), Title 72, §7601 and §7602.

ARTICLE VI
CAPITAL STOCK-FRANCHISE TAX

PART I
VALUATION OF CAPITAL STOCK

Section 601. Valuation of Capital Stock - Hereafter, except in the case of corporations of the first class, nonprofit corporations, and cooperative agricultural associations not having capital stock and not conducted for profit, banks, savings institutions, title insurance, or trust companies, building and loan associations, and insurance companies, it shall be the duty of every corporation having capital stock, every joint-stock association, limited partnership, and every company whatsoever, now or hereafter organized or incorporated by or under any laws of this Commonwealth, and of every corporation, joint-stock association, limited partnership, and company whatsoever, now or hereafter incorporated or organized by or under the law of any other state or territory of the United States, or by the United States, or by any foreign government, and doing business in and liable to taxation within this Commonwealth or having capital or property employed or used in this Commonwealth by or in the name of any limited partnership or joint-stock association, company, or corporation

whatsoever, association or associations, copartnership or copartnerships, person or persons, or in any other manner, to make annually a report in writing to the Department of Revenue on a form or forms to be prescribed and furnished by it setting forth in addition to any other information required by the Department of Revenue:

First. The amount of its capital stock at the close of the year for which report is made, together with the highest selling price per share, and the average selling price thereof during said year.

Second. Its debt account.

Third. Its income account, together with the disposition of any net income, and its profit and loss statement.

Fourth, Its general balance sheet.

Fifth, its real estate and tangible personal property, if any, owned and permanently located outside of the Commonwealth, and value of the same; and the value of the property, if any exempt from taxation.

Sixth, A valuation and appraisal, in the manner hereinafter provided, of the capital stock of the said corporation, company, joint-stock association, or limited partnership, at its actual value in cash as it existed at the close of the year for which the report is made.

The affidavit of two of the officers of such corporation, limited partnership, joint-stock association or company, shall be attached to said report. Such affidavit shall be in the form required by the Department of Revenue, but shall state, in addition to any other averments required by the department, that, with fidelity and according to the best of their knowledge and belief, the affiant have esti-

mated, valued and appraised, as shown in said report, the capital stock of the said corporation at its actual value in cash as it existed at the close of the year for which report is made; taking into consideration, first, the average which said stock sold for during the year; and second, the price or value indicated or measured by net earnings or by the amount of profit made and either declared in dividends, expended in betterment, or carried into the surplus or sinking fund; and third, the actual value indicated or measured by consideration of the intrinsic value of its tangible property and assets, and of the value of its good will and franchises and privileges, as indicated by the material results of their exercise, taking also into consideration the amount of its indebtedness.

The time for filing annual reports may be extended; taxpayers may be permitted to file their annual and tentative reports on a fiscal year basis; the procedure in case the Department of Revenue is not satisfied with the appraisement made by the officers of the taxpayer, and the penalties for failing to file reports and pay taxes shall be as prescribed by law.

Section 602. Imposition of Tax - (a) That every domestic corporation other than corporations of the first class, nonprofit corporations, and cooperative agricultural associations not having capital stock and not conducted for profit, and every joint-stock association, limited partnership, and company whatsoever, from which a report is required under Section 601 hereof, shall be subject to, and pay into the treasury of the Commonwealth annually, through the Department of Revenue, a tax at the rate of ten mills, upon each dollar of the actual value of its whole capital stock of all kinds, including common, special,

preferred, as ascertained in the manner prescribed in section 601, for the calendar year 1971 and the fiscal year beginning in 1971 and each year thereafter, except that any domestic corporation, limited partnership, joint-stock association or company subject to the tax prescribed herein may elect to compute and pay its tax under and in accordance with the provisions of subsection (b) of this section 602: Provided, That the provisions of this section shall not apply to the taxation of the capital stock of corporations, limited partnerships and joint-stock associations organized for manufacturing, processing, research or development purposes, which is invested in and actually and exclusively employed in carrying on manufacturing, processing, research or development within the State, except such companies as enjoy and exercise the right of eminent domain, but every corporation, limited partnership or joint-stock association organized for the purpose of manufacturing, processing, research or development except such companies as enjoy and exercise the right of eminent domain shall pay the State tax of ten mills herein provided, upon such proportion of its capital stock, if any, as may be invested in any property or business not strictly incident or appurtenant to the manufacturing, processing, research or development business, in addition to the local taxes assessed upon its property in the district where located, it being the object of this proviso to relieve from State taxation only so much of the capital stock as is invested purely in the manufacturing, processing, research or development plant and business.

(b) Every foreign corporation, joint-stock association, limited partnership, and company whatsoever, from which a report is required under section 601 hereof, shall be subject to and pay in to the treasury of the Common-

wealth annually, through the Department of Revenue, a franchise tax at the rate of ten mills for the calendar year 1971 and the fiscal year beginning in 1971 and each year thereafter, upon a taxable value to be determined in the following manner. The actual value of this whole capital stock of all kinds, including common, special, and preferred, shall be ascertained in the manner prescribed in section 601 of this article. The taxable value shall then be determined by employing the relevant apportionment factors set forth in Article IV: Provided, That the manufacturing, processing, research and development exemptions as contained under section 602(a) shall also apply to foreign corporations and in determining the relevant apportionment factors the numerator of the property, payroll, or sales factors shall not include any property payroll or sales attributable to manufacturing, processing, research or development activities in the Commonwealth.

The provisions of this article shall apply to the taxation of corporations, limited partnerships and joint-stock associations organized for manufacturing, processing, research or development purposes, but shall not apply to such companies as enjoy and exercise the right of eminent domain.

Act of March 4, 1971, P.L. 6, No. 2, Art IV, §401, as amended, Pa. Stat. Ann. (Purdon Supp. 1982), Title 72, §§7401(3)2.(a)(10)-(17).

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(10) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this State during the tax period and the denominator of which

is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period but shall not include the security interest of any corporation as seller or lessor in personal property sold or leased under a conditional sale, bailment lease, chattel mortgage or other contract providing for the retention of a lien or title as security for the sales price of the property.

(11) Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental paid by the taxpayer less any annual rental rate. Net annual rental rate is the annual rental paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

(12) The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(13) The payroll factor is a fraction, the numerator of which is the total amount paid in this State during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period.

(14) Compensation is paid in this State if:

A. The individual's service is performed entirely within the State;

B. The individual's service is performed both within and without this State, but the service performed without the State is incidental to the individual's service within this State; or

C. Some of the service is performed in this State and the base of operations or if there is no base of operations, the place from which the service is directed or controlled is in this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

(15) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this State during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

(16) Sales of tangible personal property are in this State if the property is delivered or shipped to a purchaser, within this State regardless of the f.o.b. point or other conditions of the sale.

(17) Sales, other than sales of tangible personal property, are in this State if:

A. The income-producing activity is performed in this State; or

B. The income-producing activity is performed both in and outside this State and a greater proportion of the income-producing activity is performed in this State than in any other state, based on costs of performance.

Appendix

BF&R 6

Docket No. C-12,883
Petition Filed: 4/23/84
Box No. 2678-228

IN RE: QUALITY MARKETS, INC.

PETITION FOR REFUND of Franchise Tax for the year ended 1/30/82.

AND NOW TO WIT June 1, A. D. 1984, I certify that the following is the action of the Board of Finance and Revenue of the Commonwealth of Pennsylvania in this Matter:

"And now to wit May 29, A. D. 1984,
After full consideration this petition is refused."

BY ORDER OF THE BOARD OF FINANCE AND REVENUE
State Treasurer, Chairman
Auditor General
Secretary of Revenue
Attorney General
General Counsel
Secretary of the Commonwealth

ATTEST: s/ R. M. Wagner
Secretary, Board of Finance and Revenue

Mailed to: Rhoads & Sinon on June 1, 1984
Attorneys at Law
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Exec. Cal. No. 25.

Appendix

QUALITY MARKETS, INC., Petitioner:	:	IN THE COMMONWEALTH COURT OF PENNSYLVANIA
v.	:	
COMMONWEALTH OF PENNSYLVANIA, Respondent:	:	No. 1692 C.D. 1984

BEFORE:
HONORABLE JAMES CRUMLISH, JR., President Judge
HONORABLE THEODORE O. ROGERS, Judge
HONORABLE DAVID W. CRAIG, Judge
HONORABLE JOSEPH T. DOYLE, Judge
HONORABLE FRANCIS A. BARRY, Judge
HONORABLE JAMES GARDNER COLINS, Judge
HONORABLE MADALINE PALLADINO, Judge

ARGUED: February 5, 1986

OPINION BY JUDGE PALLADINO

FILED: August 8, 1986

Quality Markets, Inc. (Taxpayer) appeals from an order of the Board of Finance and Revenue (Board) which refused Taxpayer's Petition for Refund of Franchise Tax for the year ending January 30, 1982. We affirm.

Appendix

The relevant facts, stipulated to by the parties, are as follows: Taxpayer is incorporated under the laws of the State of New York, and is engaged in the operation of retail grocery stores located in both New York and the Commonwealth of Pennsylvania. Of Taxpayer's twenty-one stores, thirteen are located in New York and eight are located in Pennsylvania. Taxpayer's corporate headquarters and distribution center are located in Jamestown, New York.

In October of 1982, Taxpayer filed with the Commonwealth a Franchise Tax Report for the fiscal year ending January 30, 1982, declaring a franchise tax liability of $24,660. The Department of Revenue settled the report and determined that Taxpayer owed $29,127 in franchise tax, which Taxpayer paid in full. The amount of Taxpayer's franchise tax liability was calculated according to the three-factor apportionment formula specified in Section 602(b)(1) of the Tax Reform Code of 1971.[1] This formula is designed to apportion the value of a corporation's capital stock attributable to the corporation's activities in the Commonwealth, using the three factors of tangible property, payroll, and sales.

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[1] Act of March 4, 1971, P.L. 6, *as amended*, 72 P.S. §7602(b)(1). Using three-factor apportionment, the formula for determining franchise tax is as follows:

$$\frac{\text{tangible property in Pennsylvania}}{\text{total tangible property}} = \%\ (1)$$

$$\frac{\text{wages, salaries, etc. assignable in Pennsylvania}}{\text{total wages, salaries, etc.}} = \%\ (2)$$

$$\frac{\text{sales assignable in Pennsylvania}}{\text{total sales}} = \%\ (3)$$

$$\frac{\%\ (1) + \%\ (2) + \%\ (3)}{3} = \text{apportionment factor}$$

actual value x apportionment factor x 10 mills = tax due

Appendix

In June of 1982, the Supreme Court of Pennsylvania, in *Gilbert Associates, Inc. v. Commonwealth*, 498 Pa. 514, 447 A.2d 944 (1982), held that foreign corporations must be afforded the option heretofore given only to domestic corporations, of using either the three-factor apportionment formula of the franchise tax or the single-factor apportionment formula applicable to the capital stock tax.[2] Thereafter, Taxpayer filed with the Board a Petition for Refund, claiming the right to compute its tax owed using the single-factor apportionment formula. Taxpayer conditioned its election of single-factor apportionment, however, on the assumption that Taxpayer's intangible assets are not legally includable in the single-factor apportionment calculation.[3] The Board refused Taxpayer's petition, and Taxpayer filed the instant petition for review with this Court.

The gravamen of Taxpayer's argument is that, when the single-factor apportionment formula is used, the Commonwealth may not legally tax foreign corporations as if they are domestic corporations to the extent that intangible assets are included in the single-factor apportionment fraction. Taxpayer asserts that this is so because its intangible assets have no rational or reasonable relationship to

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[2] The single-factor apportionment formula is authorized by the Act of June 22, 1931, P.L. 685, No. 250, 72 P.S. §1896. Using single factor apportionment, the tax due is calculated as follows:

$$\frac{\text{taxable assets}}{\text{total assets}} \times \text{actual value} \times \text{ten mills} = \text{tax due}$$

[3] The intangible assets at issue here include the following: cash; accounts receivable; common stocks; stock and investment certificates in Topco Associates, a buying cooperative of which Taxpayer is a member; capital leases; deferred income tax benefits; inter-company receivable; prepaid real estate taxes; and prepaid miscellaneous expenses.

Taxpayer's business activities in the Commonwealth, and are therefore not susceptible to taxation by the Commonwealth. Specifically, Taxpayer contends that such taxation of its intangible assets by the Commonwealth is violative of the Due Process Clause and Commerce Clause of the United States Constitution, and of the Uniformity Clause of the Constitution of the Commonwealth of Pennsylvania. Accordingly, the sole issue presented for our review is one of law: whether a foreign corporation which elects to be taxed under the single-factor apportionment formula may be legally and constitutionally required to include its intangible assets in the computation of its franchise tax due.

In Pennsylvania, both domestic corporations (incorporated under the laws of the Commonwealth) and foreign corporations (incorporated elsewhere) are subject to an annual tax based on the value of the corporation's capital stock. As the Supreme Court of Pennsylvania noted in *Gilbert Associates*,

> [p]rior to 1967, two distinct methods of calculating taxable capital stock value were applied to domestic and foreign corporations. In the case of domestic corporations, the actual value of capital stock was multiplied by a percentage derived from a single-factor formula. This formula was based on the proportion which the value of non-exempt assets bore to the value of total assets by the corporation. Act of June 22, 1931, P.L. 685, §1, 72 P.S. §1896. In the case of foreign corporations, the actual value of capital stock was multiplied by a percentage derived from a three-factor formula. This formula was based on the average of tangible property, payroll and gross receipts attributable to Pennsylvania. Act of May 16, 1935, P.L. 184, 72 P.S. §7602(a).

Gilbert Associates, 498 Pa. at 516-517, 447 A.2d at 945. The distinction drawn between domestic and foreign corporations, and the different methods used to calculate their taxable capital stock value, have been determined to be constitutional because "[a]n equivalent tax burden is imposed on both classes of corporations." *Commonwealth v. Ford Motor Co.*, 350 Pa. 236, 38 A.2d 329, 337 (1944). Moreover, as used in the taxation of foreign corporations, the three-factor apportionment formula has met with approval from the Supreme Court of the United States, which has noted that the three-factor method has become "something of a benchmark against which other apportionment formulas are judged." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 170 (1983).

In 1967, the Legislature amended the taxing statutes to afford a domestic corporation with income taxable outside Pennsylvania the option of having its capital stock value measured by either the previously mandatory single-factor formula or the three-factor formula mandatory for foreign corporations, thus allowing the domestic corporation to choose whichever formula would afford it a greater tax advantage.[4] In *Gilbert Associates*, our Supreme Court determined that, by granting domestic corporations an option in the nature of an exemption or deduction, the Legislature had imposed unequal tax burdens upon domestic and foreign corporations which were "unrelated to any discernable difference between domestic and foreign corporations other than their place of incorporation. . . ." *Gilbert Associates*, 498 Pa. at 519, 447 A.2d at 947. Accordingly, the Supreme Court held that:

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[4] Act of October 19, 1967, P.L. 446, amending Act of June 1, 1889, P.L. 420, 72 P.S. §1871(a).

> Although the Legislature was in no respect obliged to grant domestic corporations the option to measure their taxable capital stock value on the basis of either the single-factor or three-factor apportionment formula, the Constitutions of Pennsylvania and the United States require that, once such an option has been granted to domestic corporations, an equivalent option must be granted to similarly situated foreign corporations.

Id. at 520, 447 A.2d at 947.

Clearly, the Commonwealth does not have the power to levy a capital stock tax or a franchise tax upon intangible assets held by a foreign corporation doing business in the Commonwealth, which assets have no connection with this state. *See Norfolk and Western R. Co. v. Missouri Tax Commission*, 390 U.S. 317 (1968); *and Commonwealth v. Universal Trades*, 392 Pa. 323, 141 A.2d 204 (1958). If, therefore, foreign corporations were required to utilize only the single-factor apportionment formula, which includes such intangible assets, an unconstitutional result would occur. This is not the case presented in the instant matter, however, because Taxpayer was afforded an option to choose between the single-factor and three-factor formulas, and it is this option which must be scrutinized, as a whole, to determine if it passes constitutional muster. We conclude that this option, as applied to Taxpayer, is constitutional.

In *Commonwealth v. After Six, Inc.*, 489 Pa. 69, 413 A.2d 1017 (1980), a domestic corporation elected to compute its tax using the three-factor franchise tax formula, but attempted to retain certain exclusions available to domestic corporations only under the single-factor meth-

od. The Supreme Court of Pennsylvania held that the corporation must forego such exclusions if it elects to use the three-factor method, and that "a domestic taxpayer who elects to use the franchise tax method must be placed on exactly the same footing as a foreign corporation paying its franchise tax." *Id.* at 81, 413 A.2d at 1023. The Court stated specifically that, despite the possibility of double taxation, the 1967 amendment granting domestic corporations the option to choose between the two formulas was nevertheless valid, because it "sought to allow domestic corporations to reduce their tax liability below the amount obtained by using the single fraction formula," where the exclusions were available. *Id.* at 82, 413 A.2d at 1023.

Similarly, in the case at bar, despite Taxpayer's contention that inclusion of its intangible assets in the single-factor apportionment formula will result in the taxation of assets unconnected with the Commonwealth, we determine that the option to choose between tax formulas, as accorded to Taxpayer, is nevertheless valid. As was stated in *Gilbert Associates,* the option given to both foreign and domestic corporations is in the nature of an exemption or deduction. If Taxpayer elected to calculate its taxes under the three-factor formula, which considers only the portion of a corporation's tangible property, wages, and sales attributable to Pennsylvania, then Taxpayer's Pennsylvania-related assets only would be taxed. Because Taxpayer is afforded an option to choose between tax formulas, Taxpayer will choose the formula which provides the greatest tax advantage, and will elect to use the single-factor formula only if it results in a tax liability lower than that calculated using the three-factor method. Because the greatest possible amount of tax that Taxpayer will be required to pay is the amount calculated using the three-factor formula, the

option to choose between tax formulas is not constitutionally infirm, despite the fact that, for Taxpayer, the option does not result in an exemption or deduction.

The Due Process Clause of the fourteenth amendment to the United States Constitution[5] imposes two requirements on a state's taxation of a business operating in interstate commerce: "a minimal connection 'or nexus' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207, 219-220 (1980). Similarly, under the Commerce Clause,[6] such taxation is valid if it "is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 443 (1980). We conclude that, in the instant case, the option to choose between the single-factor and three-factor tax formulas, as afforded to foreign corporations, meets these requirements.

The 'nexus' requirement is met "if the corporation avails itself of the substantial privilege of carrying on business within the State." *Exxon Corp.*, 447 U.S. at 220. Taxpayer, which operates eight stores in the Commonwealth, clearly avails itself of this "substantial privilege."

The requirement that the tax be fairly apportioned is met if the tax is not "out of all appropriates proportion to the business transacted by the [taxpayer] in that State." *Id., quoting Hans Rees' Sons v. North Carolina ex rel.*

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[5] U.S. Const. amend. XIV, §1.

[6] U.S. Const. art. I, §8, cl. 3.

Maxwell, 283 U.S. 123 (1931). As noted previously, the option afforded Taxpayer is intended to provide a possible deduction from the amount of tax a foreign corporation would owe if it was required to use the three-factor apportionment formula. Because the three-factor formula is accepted as a means of reaching a fair apportionment, *Container Corp. of America*, and because Taxpayer can expect to pay, at most, the amount of tax calculated using the three-factor formula, the option to choose between tax formulas necessarily results in a fair apportionment of taxes to Taxpayer's business conducted in the Commonwealth.

The further requirement of the Commerce Clause that the tax not discriminate against interstate commerce "has not in practice required much in addition to the requirement of fair apportionment." *Id.* at 171. Here, as mentioned above, the option to choose between tax formulas does fairly apportion the amount of tax to Taxpayer's assets connected with the Commonwealth. Moreover, having been granted the option, Taxpayer and all other foreign corporations are treated the same as domestic corporations. Accordingly, the existence of the option does not discriminate against interstate commerce.

As for the Commerce Clause requirement that the tax be fairly related to the services provided by the Commonwealth, we note that the "services" referred to "include not only police and fire protection, but also the benefits of a trained work force and the advantages of a civilized society." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 445 (1979). Unquestionably, Taxpayer's eight stores located in the Commonwealth have available to them the full range of such services.

Finally, we note that the option accorded to Taxpayer does not violate the Uniformity Clause of the Pennsylvania

Constitution.[7] Under this clause, once a foreign corporation is allowed to do business in Pennsylvania, "it must be treated uniformly with domestic corporations in the absence of any reasonable basis for according separate treatment." *Columbia Gas Transmission Corp. v. Commonwealth*, 468 Pa. 145, 154, 360 A.2d 592, 597 (1976). Tax classifications "based solely on place of incorporation, without any further justification, cannot stand constitutional scrutiny." *Id.* at 150, 360 A.2d at 595; *see also Gilbert Associates*. Here, Taxpayer and all other foreign corporations are given the same option to choose between tax formulas as is accorded to domestic corporations, and the tax liability of a corporation is calculated under either formula without regard to whether the corporation is foreign or domestic. Therefore, the requirements of the Uniformity Clause are in no way abridged.

The order of the Board is affirmed.[8]

s/ MADALINE PALLADINO, JUDGE

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[7] Pa. Const. art. 8, §1, which provides as follows:

> "All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws."

[8] In its brief, the Commonwealth contends that Taxpayer, in filing its Petition for Refund, has made an irrevocable election to compute its tax liability under the single-factor apportionment formula, and that Taxpayer is therefore liable for additional tax as calculated using the single-factor apportionment fraction which includes Taxpayer's intangible assets. We note, however, that Taxpayer's tax liability has already been settled by the Board using the three-factor apportionment method, and the amount of tax calculated thereunder has been paid by Taxpayer. Accordingly, we find that, under the particular facts presented in the case at bar, Taxpayer's Petition for Refund, which was made in response to the Supreme Court's decision in *Gilbert Associates*, did not constitute an irrevocable

Appendix

QUALITY MARKETS, INC., Petitioner:	:	IN THE COMMONWEALTH COURT OF PENNSYLVANIA
v.	:	
COMMONWEALTH OF PENNSYLVANIA, Respondent:	:	No. 1692 C.D. 1984

ORDER

AND NOW, August 8, 1986, the order of the Board of Finance and Revenue denying Petitioner's Petition for Refund, at Board Docket No. C-12,883, dated June 1, 1984, is affirmed.

s/ MADALINE PALLADINO, JUDGE

CERTIFIED FROM THE RECORD
Aug. 8, 1986
s/ C. R. Hostutler
Deputy Prothonotary—Chief Clerk

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election to use the single-factor apportionment formula, and the Board is bound by the terms of the settlement it had previously approved. We therefore affirm the denial of Taxpayer's Petition for Refund, but we do not impose additional tax.

Appendix

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

QUALITY MARKETS, INC., :

Petitioner:

v.

COMMONWEALTH OF PENNSYLVANIA, :

Respondent: NO. 1692 C. D. 1984

PER CURIAM

ORDER

NOW, September 11, 1986, petitioner's exceptions are hereby dismissed and our prior Order of August 8, 1986 is hereby entered as the final order in this case.

CERTIFIED FROM THE RECORD
Sep. 11, 1986
s/ C. R. Hostutler
Deputy Prothonotary—Chief Clerk

Appendix

[J-110 of 1987]
IN THE SUPREME COURT OF PENNSYLVANIA
Middle District

QUALITY MARKETS, INC., Appellant:	:	No. 43 M. D. Appeal Dkt. 1986
	:	Appeal from Order of Commonwealth Court entered
v.	:	September 11, 1986, at No. 1692 C.D. 1984, Affirming Order of Board of
COMMONWEALTH OF PENNSYLVANIA	:	Finance and Revenue entered June 1, 1984, at Docket No. C-12,883
	:	Pa.Commw. , 514 A.2d 228 (1986)
	:	Argued: May 13, 1987

ORDER

PER CURIAM

FILED: JUNE 1, 1987

Order affirmed.

June 1, 1987
Judgment Entered

s/ Mildred E. Williamson
Deputy Prothonotary

Appendix

IN THE SUPREME COURT OF PENNSYLVANIA

QUALITY MARKETS, INC., Appellant:	:	
	:	No. 43 M.D. Appeal
v.	:	Docket 1986
	:	
COMMONWEALTH OF PENNSYLVANIA, Appellee:	:	

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Quality Markets, Inc., the Appellant in the above-captioned matter, hereby appeals to the Supreme Court of the United States from the final order and judgment of the Supreme Court of Pennsylvania entered in this action on June 1,1987, affirming the order of the Commonwealth Court of Pennsylvania entered September 11, 1986, at No. 1692 C.D. 1984, affirming the Order of the Board of Finance and Revenue entered June 1, 1984, at Docket No. C-12,883.

This appeal is taken pursuant to Title 28, United States Code, Section 1257, subparagraph 2.

RHOADS & SINON

Dated August 10, 1987

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